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In the Supreme Court of the United States

OCTOBER TERM, 1976

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

SHARON L. KING
One First National Plaza
Suite 4200
Chicago, Illinois 60603
Counsel for Petitioner

of Counsel:

ROBERT E. CRONIN
GERALD D. MINDELL
THOMAS G. RYAN
PHILIP P. STEPTOE

ISHAM, LINCOLN & BEALE

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings of fact and conclusions of law of the district court (App. 14–18) are reported at 405 F. Supp. 748 (S.D. Ill. 1975). The opinion of the court of appeals (App. 20–27) is reported at 540 F.2d 300 (7th Cir. 1976).

JURISDICTION

The judgment of the court of appeals (App. 28) was entered on August 17, 1976. A timely petition for rehearing was denied on November 4, 1976 (App. 30). The petition for a writ of certiorari was filed on February 1, 1977, and certiorari was granted on May 2, 1977 (App. 31). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

Sections 3401 and 3402 of the Internal Revenue Code of 1954 require an employer to withhold federal income taxes only on a payment of "wages." "Wages" are defined in the statute to mean "remuneration . . . for services performed." The questions presented are:

(1) Whether virtually all payments deemed to arise out of, or be attributable to, the employment relationship, such as reimbursements of legitimate noon meal expenses incurred by employees when traveling on required trips, not involving an overnight stay, for the business of their employer, constitute "wages" for withholding tax purposes.

(2) Whether withholding tax obligations may be imposed retroactively on an employer as a matter of law, as the decision below in effect held, if payments subsequently are deemed to be "wages."

STATUTES AND REGULATIONS INVOLVED

The relevant portions of Sections 3401(a), 3402(a) and 3403 of the Internal Revenue Code of 1954 (26 U.S.C.) and of Treasury Regulations, Section 31.3401(a)-1 (26 C.F.R.), are set forth in the Appendix, *infra*, pp. A-1 *et seq.*

STATEMENT

1. The Company[1] is a public utility engaged in the generation, transmission, distribution and sale of electric energy and the distribution and sale of natural gas in Illinois. In accordance with its long-standing policy, the Company reimburses its employees for legitimate expenses of transportation, meals and lodging incurred in required trips for the Company's business. The Company follows the same policy and reimburses on the same basis for overnight trips as for

[1]Petitioner is hereinafter referred to as the Company.

trips where the employee returns before time to sleep (App. 16, 22; Transcript 24–29, 37, 46).

An employee traveling for the Company is required to make an accounting of his expenditures on a Company form and submit the form to a supervisor for approval before reimbursement is made by the Company. In accordance with Treasury regulations, receipts also are required if expenditures exceed $25 (App. 16; Transcript 28, 44).

Reimbursements to unionized employees and operating employees of the Company's western division (a non-unionized division of the Company) for noon meal expenses incurred while traveling for the Company were in an amount not to exceed $1.40 in 1963, the year in question, regardless of the cost of the meal. The amount was based on the union's collective bargaining agreement with the Company. All other employees were reimbursed for the actual cost of meals while traveling if the amounts were reasonable (App. 16; Transcript 29–30).

Depending on the individual and the circumstances, the $1.40 rate was sometimes in excess of the actual lunch cost but very often it was insufficient to cover the cost. Many of these employees were men engaged in open-air labor. On rare occasions when the convenience of the Company required it, the employees on Company travel brought their lunch from home and were entitled to the $1.40 reimbursement. Many of the employees ate lunch at home when they were not traveling on the business of the Company (App. 16; Transcript 94, 110, 113, 116–17, 124, 128, 135, 140–41, 143).

The accounts of employees entitled to receive reimbursement for actual costs expended were carefully reviewed, were subject to question ($2.50 was considered questionable by

trial date prices) and would be disallowed if they were determined not to be reasonable (Transcript 64–66).

The Company's reimbursement policy was based on serving its business interest. The amount of the meal reimbursements was unrelated to the employee's specific job title, the nature of his work, his rate of pay or the value of his service to the Company (App. 17).

During 1963, the Company paid federal income withholding taxes of $1,966,489.87. On audit, the Internal Revenue Service determined that the Company should have withheld an additional $25,188.50 on account of reimbursements paid to employees for noon meal expenses incurred by them while traveling on nonovernight trips for the business of the Company. None of the other travel expense reimbursements made by the Company to its employees in 1963 was asserted to be "wages" subject to withholding (App. 8, 12, 15, 16; Transcript 46).

2. The district court held that the meal reimbursements were not "wages" for withholding tax purposes, favorably citing the Fourth Circuit's views expressed in *Royster Co.* v. *United States*, 479 F.2d 387 (1973) (App. 14–18). The district court observed that to accept the government's view of the reimbursements as "wages" would require "a departure from the realities of business life and a vigorous stretching of the statute . . ." (App. 17). The district court noted that the decision of this Court in *United States* v. *Correll*, 389 U.S. 299 (1967), denying an employee an income tax deduction for meal expenses incurred on nonovernight trips, does not automatically require withholding by employers on reimbursements of such expenses.

The court of appeals reversed (App. 20–27). In holding that the reimbursements constituted "wages," the court in

effect equated "wages" with "income." The court's "expansive" definition of "wages" would include within such term virtually every item attributable to the employment relationship.

SUMMARY OF ARGUMENT

I

This case focuses upon the income tax withholding provisions of the Internal Revenue Code of 1954 wherein "wages" is narrowly defined as "remuneration . . . for services performed." Section 3401(a). The expansive definition substituted by the court of appeals below and urged by the government would include within "wages" virtually every item somehow attributable to the employment relationship. To so expand the definition, however, is to ignore applicable judicial precedent and administrative practice, including the government's own rulings, and effectively to rewrite the statutory provisions.

Legislative history which can be traced back over a half century demonstrates the intent of Congress to confine the scope of employers' withholding obligations. "[S]implicity and ease of administration" (S. Rep. No. 1631, 77th Cong., 2d Sess. 165, *reprinted in* 1942-2 Cum. Bull. 504, 626) provided the underpinnings of the withholding system at its inception in 1942 as well as today. The government and the court below would not only overlook Congressional intent but also the explicit language of long-standing Treasury regulation §31.3401(a)-1(b)(2), which provides that "[a]mounts paid—either as advancements or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred . . . in the business of the employer are not wages and are not subject to withholding."

The failure of the court below to abide by the language of the regulation is astonishing considering its recognition that the reimbursed amounts in this case represented legitimate

travel expenses incurred by employees on the business of the Company (App. 22).

Both the court of appeals below and the government erroneously rely upon income tax authorities to support their all-inclusive view of "wages." "Income" cases cannot be bootstrapped into support for an expansive view of "wages". Congress, the government and the courts have recognized the fundamental distinction between "wages" and "income," namely that "[t]he term 'wages' has a much narrower meaning than the term income, because wages are merely one form of income." *Humble Pipe Line Co.* v. *United States*, 442 F.2d 1353, 1356 (Ct. Cl. 1971). Indeed, in a case "not meaningfully distinguishable from the present case" (App. 26), the Fourth Circuit in *Royster Co.* v. *United States*, 479 F.2d 387 (4th Cir. 1973), rejected an attempt by the government to equate "wages" and "income," stating that: "Wages are merely one form of income. The government's position might well render nugatory any distinction between the two." 479 F.2d at 390.

Judicial precedent, administrative practice and the applicable Treasury regulations under Section 3401 long have recognized that noncompensatory payments to employees made in furtherance of the employer's business do not fall within the category of "wages." Even the government acknowledges this principle (*see* Brief for Petitioner at 25, *Commissioner* v. *Kowalski*, No. 76-1095). The substantial noncompensatory business reasons for the Company's reimbursement policy are unmistakably indicated by the facts of this case. Indeed, both courts below acknowledged that the reimbursements were for legitimate travel expenses incurred on the business of the Company (App. 16, 22).

The court of appeals below premised its expansion of the definition of "wages" upon the erroneous assumption that such an expansion would further the underlying purpose of

the withholding system. In fact, nothing could be further from the truth. A viable withholding system requires specific and simple guidelines. Now the government, with the aid of the decision of the court below, would substitute confusion for the avowed objectives of simplicity and administrative ease. Not only would the decision of the court of appeals below place nearly every employer, including the government, in violation of the withholding provisions, but it would jeopardize the future of the entire withholding system.

II

It is an abuse of discretion to impose retroactively upon employers an expansion of the income tax withholding system. Congress has always permitted employers a grace period to adjust to new withholding obligations and has considered such a practice to be "a matter of equity and custom." S. Rep. No. 66, 95th Cong., 1st Sess. 85-87. Here, however, the government would ignore the Congressional practice and in so doing convert the employer into a guarantor of its employees' income taxes.

Such a conscription of the employer has been criticized by the courts (*see Humble Oil & Refining Co.* v. *United States*, 442 F.2d 1362, 1369-70 (Ct. Cl. 1971)), and Congress has cautioned that such action creates havoc in the withholding system. Not only would the government in this case place a never-intended burden on employers, but would do so retroactively. This grates against fundamental fairness and, as even the Internal Revenue Service has recognized, inflicts a harsh result. *See* IRS News Release IR-1724, [1977] Stand. Fed. Tax. Rep. (CCH) ¶6630; IRM MT 4600-21 (5/1/74) (Official Use Only): Technical Guidelines for Disposition of Employment Tax Cases.

It cannot be disputed that it was reasonable for the Company in this case to believe that the rembursements for

admittedly legitimate travel expenses paid in 1963 were not "wages." Indeed, the language of Treasury regulation §31-3401(a)-1(b)(2) specifically confirms such a belief. Fourteen years ago neither the Company, nor any other employer in the country, could be expected to foresee a withholding requirement on such travel reimbursements. The government, in effect, stated as much to the court below (*see* Reply Brief of Appellant at p. 15). In 1963, not one regulation, revenue ruling or judicial decision required withholding on any travel expense reimbursements.

ARGUMENT

I

MEAL REIMBURSEMENTS NECESSITATED BY A NONCOMPENSATORY BUSINESS REASON OF AN EMPLOYER DO NOT CONSTITUTE WAGES FOR FEDERAL WITHHOLDING TAX PURPOSES

The breadth of the term "wages" possesses enormous significance to every employer in the United States because an employer's obligation to withhold federal income taxes is based on the meaning of "wages." If the definition of wages changes, so does the obligation of every employer. At stake in this case is an attempt by the government to make a fundamental revision of employers' withholding obligations. Relying on income tax authorities to support its position, the government has argued that virtually every payment arising out of the employment relationship constitutes "wages," upon which an employer must withhold. The government in seeking to expand the definition of "wages" would rewrite the statute, the regulations, the government's own rulings and a plethora of decided cases.

It must be emphasized that in the present case the Court is not dealing with the concept of "income" as it has developed for federal income tax purposes. Instead, the

Court is asked to focus upon Sections 3401(a) and 3402 of the Internal Revenue Code of 1954 ("the Code"), which, by their express terms, require withholding only on "wages," *i.e.*, "remuneration ... for services performed." As observed by Mr. Justice Frankfurter in *Estate of Rogers* v. *Commissioner*, 320 U.S. 410, 413 (1943), "the right answer usually depends on putting the right question." The right question in this case is not whether the payments were "income" to the employee under Section 61 of the Code but is the much narrower question of whether the payments constitute "wages" for withholding tax purposes.

Specifically, this Court must decide whether certain meal expense reimbursements paid by an employer to employees traveling on nonovernight business trips for the employer are "wages" subject to withholding. The district court below found (App. 14 *et seq.*) that the reimbursements were made by the Company for legitimate business reasons unrelated to compensating its employees and therefore were not "remuneration ... for services performed." The court of appeals below, while acknowledging that the cost of meals represented legitimate travel expenses, reversed (App. 20 *et seq.*) and held, in effect, that the Company's substantial noncompensatory business reasons for the reimbursement arrangement were irrelevant to its withholding obligations. In doing so the court of appeals abandoned the statutory definition of the term "wages," as well as over thirty years of applicable judicial and administrative precedent.

A. THE TERM "WAGES" IS NARROWER THAN THE TERM "INCOME" AND DOES NOT INCLUDE REIMBURSEMENTS FOR LEGITIMATE TRAVEL EXPENSES INCURRED ON BEHALF OF THE EMPLOYER

An employer is required by Section 3402 of the Code to withhold federal income taxes only upon "wages." Section 3401(a) of the Code defines "wages":

> For purposes of this chapter, the term "wages" means all *remuneration ... for services performed* by an employee

> for his employer, including the cash value of all remuneration paid in any medium other than cash. . . . (emphasis supplied)

The legislative history of the income tax withholding system establishes an intentionally narrow and precise scope to employers' obligations through the limitation of withholding to "wages."

The first income tax law following the adoption of the Sixteenth Amendment—the Tariff of 1913—contained a short-lived attempt to collect all income taxes at the source through a catch-all withholding provision:

> All persons . . . having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual gains, profits and income of another person, exceeding $3,000 for any taxable year, . . . are hereby authorized and required to deduct and withhold from such annual gains, profits and income such sum as will be sufficient to pay the normal tax imposed thereon by this section. . . .[2]

The Revenue Act of 1917 repealed this "collection at the source" provision.[3]

When the present income tax withholding system was conceived in 1942,[4] Congress elected not to return to the all-in-

[2]c.16, §2E, 38 Stat. 114 (1913).

[3]Congress replaced the withholding provision with the ancestor of the present "information at the source" provisions found in Section 6041 *et seq.* of the Code. (*See* Appendix, *infra*, A-1). This substitution was made at the request of the Secretary of the Treasury, who told Congress that collections had been disappointing, and that "excessive and erroneous withholding at the source" had caused great administrative expense in adjusting claims for refund. 55 Cong. Rec. 5967 (1917). *See also* [1917] Treasury Dept. Rep. on the Finances 666–67.

[4]The origin of the present income tax withholding provisions, Section 3401 *et seq.* of the Code, is found in the "Victory Tax"

(footnote continued next page)

clusive provision of the Tariff of 1913. While the House proposal would have included withholding on dividends and bond interest as well as "wages," the Senate version, ultimately adopted in conference, confined the obligation to wages "in the interest of simplicity and ease of administration."[5] Committee reports state that wages meant remuneration only "*if* paid for services performed by an employee for his employer" (emphasis supplied).[6] This language also appears in the regulations.[7]

Current Treasury regulations first issued in 1943—at the inception of the present withholding system—demonstrate that payments made by an employer for its own noncompensatory business purposes are not "wages" subject to with-

provisions of the Revenue Act of 1942, c. 619, §172, 56 Stat. 798 (1942) (repealed by the Individual Income Tax Act of 1944) which was followed by the Current Tax Payments Act of 1943, c. 120, §2(a), 57 Stat. 126 (1943).

[5]S. Rep. No. 1631, 77th Cong., 2d Sess. 165, *reprinted in* 1942–2 Cum. Bull. 504, 626. Attempts to expand withholding to include interest and dividends were again defeated in 1962 and 1976. *See* S. Rep. No. 1881, 87th Cong., 2d Sess. *reprinted in* [1962] U.S. Code. Cong. & Admin. News 3297, 3422–23; Conf. Rep. No. 2508, 87th Cong., 2d Sess., *reprinted in* [1962] U.S. Code Cong. & Adm. News 3732, 3762–63; Amendment No. 1910 to H.R. 10612, 94th Cong., 2d Sess. (1976), defeated in the Senate on June 30, 1976, debate *reprinted in Oversight Hearings into the Operations of the IRS (Income Information Document Matching Program)*: Hearing before the Commerce, Consumer, and Monetary Affairs Subcomm. of the House Comm. on Government Operations, 94th Cong., 2d Sess. 140–78 (1976).

[6]H.R. Rep. No. 2333, 77th Cong., 1st Sess. 126, *reprinted in* 1942–2 Cum. Bull. 372, 465; S. Rep. No. 1631, 77th Cong., 2d Sess. 166, *reprinted in* 1942–2 Cum. Bull. 504, 626; H.R. Rep. No. 401, 78th Cong., 1st Sess. 22, *reprinted in* 1943 Cum. Bull. 1283, 1299, S. Rep. No. 221, 78th Cong., 1st Sess. 17, *reprinted in* 1943 Cum. Bull. 1314, 1327; H.R. Rep. No. 510, 78th Cong., 1st Sess. 2, *reprinted in* 1943 Cum. Bull. 1351, 1352.

[7]Current Treas. Reg. §31.3401(a)-1(a)(2).

holding. Treas. Reg. §31.3401(a)-1(b)(2)[8] provides in pertinent part:

> Traveling and other expenses. Amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding.

Despite the fact that courts have long recognized that contemporaneous administrative regulations must be accorded great weight in interpreting a statute,[9] the court of appeals below sought to dispose of this long-standing regulation in a footnote (App. 27 n.3). Without disputing the district court's finding that the employees were traveling on the Company's business, and in fact so confirming in its own summary of the facts (App. 22), the court stated that the regulation did not apply because the employees were not on overnight trips and therefore were not in travel status for purposes of the regulation. The court relied upon this Court's decision in *United States* v. *Correll*, 389 U.S. 299 (1967), which did not even consider the withholding provisions.

[8]Originally promulgated in Section 404.14 of T. D. 5277, 1943 Cum. Bull. 927, 941 (June 28, 1943). *See also* Treas. Reg. §31.3401(a)-1(b)(10), promulgated in Section 404.15 of T.D. 5277, which provides that facilities and privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases) offered by the employer as a means of promoting the health, good will, contentment, or efficiency of its employees are not "wages."

[9]The value to the courts of contemporaneous regulations is founded upon the view that:

> The first administrative interpretation of a provision as it appears in a new act often expresses the general understanding of the times or the actual understanding of those who played an important part when the statute was drafted.

Augustus v. *Commissioner*, 118 F.2d 38, 43 (6th Cir. 1941). *See also Edwards's Lessee* v. *Darby*, 25 U.S. 126, 129, 12 Wheat. 206, 210 (1827); *National Lead Co.* v. *United States*, 252 U.S. 140, 145–46 (1920).

This Court in *Correll*, for reasons of administrative convenience, held that the phrase "away from home" in Section 162(a)(2) of the Code limits employees to an income tax deduction for certain travel expenses only if they are incurred on overnight trips. Nothing in this Court's decision in *Correll* suggests or supports the lower court's conclusion that the disallowance of the income tax deduction could convert an item which is not a "wage" into one which is.

Treasury Regulation §31.3401(a)-1(b)(2), in excluding reimbursements of travel and other expenses from "wages," is significant in the absence from it of the "away from home" language of Section 162(a)(2). The "overnight" concept was never included in the withholding regulations. The absence of the "away from home" language is hardly an oversight. The government argued to the court of appeals below that the Internal Revenue Service had "consistently since 1940" taken the position that travel expenses on nonovernight trips were not deductible by employees under Section 162(a)(2) of the Code (Reply Brief at 17). It is curious, indeed, that the government, if it thought the overnight concept had application to withholding, did not see fit to incorporate it in the withholding regulations which it drafted only a few years later in 1943. We believe that the government in promulgating the regulations under the withholding tax provision did not deem the allowance or disallowance of a deduction to employees for travel expenses as having any bearing on the withholding requirements of the employers because reimbursements for travel expenses were never considered to fall within the limited term "wages."[10]

[10]Reimbursements of traveling expenses made to employees, whether for transportation, meals or lodging, long have been considered "income" to the employee under Section 61 of the Code and its predecessors, but never before have been considered "wages" because such payments are not "for services performed." The allowance or disallowance to the employee of an offsetting income tax deduction for such amounts does not, and cannot, change the basic nature of the payment.

It is evident that the attempt of the court of appeals to use this Court's holding in *United States* v. *Correll*, 389 U.S. 299 (1967), to support its conclusion that the reimbursements involved in this case were "wages" cannot stand. This Court in *Correll* neither considered nor decided the withholding tax treatment of the payments to employees, nor was it asked to do so. Moreover, legislative history and the Treasury regulations preclude such a bootstrapping of *Correll*.

Congress, the Internal Revenue Service and the courts repeatedly have recognized in the past that a change in the income tax treatment of an item does not thereby convert an otherwise non-wage item into a "wage" for federal withholding tax purposes. In 1964, when Congress added Section 79 to the Code (making group term life insurance purchased by employers taxable to employees), it expressly rejected a proposal to include this benefit in "wages."[11] In 1969, when Congress brought employer reimbursements for certain moving expenses within the definition of gross income, it deliberately drafted the language of Section 82 of the Code so that it unambiguously informed employers that withholding is required on such reimbursements.[12]

The administrative practice of the Internal Revenue Service, as embodied in many of its revenue rulings, has long recognized the fundamental distinction between the income tax treatment with respect to an employee and the withholding requirements of an employer. In many instances, the Service has stated that cash payments from an employer to an

[11] *See* S. Rep. No. 830, 88th Cong., 2d Sess. *reprinted in* [1964] U.S. Code. Cong. & Adm. News 1868, 1878–79; H.R. Rep. No. 1149, 88th Cong., 2d Sess. *reprinted in* [1964] U.S. Code. Cong. & Adm. News 1940, 1959.

[12] *See* S. Rep. No. 552, 91st Cong., 1st Sess. *reprinted in* [1969] U.S. Code. Cong. & Adm. News 2027, 2141; H.R. Rep. No. 413, 91st Cong., 1st Sess. *reprinted in* [1969] U.S. Code. Cong. & Adm. News 1645, 1723.

employee would not be subject to withholding despite the fact that the payments would be includable in the employee's gross income. For example, in Rev. Rul. 55–520, 1955–2 Cum. Bull. 393, the Service held that an amount paid to an individual as a compromise settlement for the cancellation of the unexpired portion of the individual's employment contract did not represent wages upon which the employer was obliged to withhold. Such amount was, however, to be included in the individual's gross income for federal income tax purposes. Rev. Rul. 56–249, 1956–1 Cum. Bull. 488, dealt with trust payments to an employee from an employer's supplemental unemployment benefit plan. The Service held that the payments did not constitute wages but were includable in the employee's gross income. Similar rulings holding that not every income item arising out of the employment relationship is a "wage" subject to withholding appear in Rev. Rul. 58–301, 1958–1 Cum. Bull. 23 (cancellation of employment contract), Rev. Rul. 58–145, 1958–1 Cum. Bull. 360 (athlete's bonus for signing a professional contract) and Rev. Rul. 59–227, 1959–2 Cum. Bull. 13 (lump sum payment to employee for relinquishment of seniority rights and acceptance of new position), modified and superseded prospectively by Rev. Rul. 75-44, 1975-1 Cum. Bull. 15.

The decision of the court below represents a marked departure from the decisions of other courts which have consistently rejected attempts to equate "income" with "wages." For example, in *Peoples Life Insurance Co.* v. *United States*, 373 F.2d 924 (Ct. Cl. 1967), the court rejected the government's reliance upon "income" cases in applying the withholding provisions:

> [The income cases] were not concerned with the different problem of what, in a proceeding involving only the employer, constitutes "wages" or "remuneration" within the meaning of the withholding tax provisions. There is no necessary correlation between what constitutes

> "wages" or "remuneration" paid by an employer within the meaning of the employment or withholding tax sections and what constitutes "income" to the employee within the meaning of the "gross income" sections.

373 F.2d at 932 (footnotes omitted). *Accord, Acacia Mutual Life Insurance Co.* v. *United States*, 272 F.Supp. 188 (D. Md. 1967).

The distinction between wages and income (and the impropriety of utilizing income cases to resolve issues concerning wages) was again emphasized by the companion *Humble* cases, *Humble Pipe Line Co.* v. *United States*, 442 F.2d 1353 (Ct. Cl. 1971), and *Humble Oil & Refining Co.* v. *United States*, 442 F.2d 1362 (Ct. Cl. 1971). In both cases, relocation expense reimbursements to employees were held not to be wages. The *Humble Pipe Line* court noted that "[t]he term 'wages' has a much narrower meaning than the term income, because wages are merely one form of income." 442 F.2d at 1356.

And in *Stubbs, Overbeck & Associates, Inc.* v. *United States*, 445 F.2d 1142 (5th Cir. 1971), the Fifth Circuit considered whether the income tax withholding provisions applied to per diem payments which were made as a living allowance to employees located at a job site remote from the employer's regular place of business. In holding that the payments did not represent "wages," the court remarked:

> [W]e are not concerned with what constitutes taxable income to the employee. . . . Whether or not payments are taxable to, or deductible by, the employee is immaterial with regard to whether they are subject to withholding by the employer.

445 F.2d at 1149.

The Fourth Circuit in *Royster Co.* v. *United States*, 479 F.2d 387 (4th Cir. 1973), considered whether meal reimbursements

to employee-salesmen traveling in the sales territory of the employer constituted "wages." In the district court in *Royster*, the government abandoned its position that the income tax provisions of the Code were *in pari materia* with the withholding provisions. *See* 479 F.2d at 388. However, the government attempted in the Fourth Circuit indirectly to resurrect its discarded argument by insisting that wages be construed as encompassing everything "attributable to the employment relationship." 479 F.2d at 390. This new argument, as the Fourth Circuit emphasized, was merely another attempt—in different guise—to equate "wages" with "income." The court refused to make the equation, indicating that "wages" is a narrower term than income. "Wages are merely one form of income. The government's position might well render nugatory any distinction between the two." *Id.* The Fourth Circuit, properly noting that the "right question" was whether the payments were made to the employees as remuneration for services performed, concluded that the meal expense reimbursements did not represent "wages."

The court of appeals below acknowledged that its decision was in conflict with *Royster*, commenting "[t]he government concedes, as it must, that *Royster* is not meaningfully distinguishable from the present case" (App. 26). While purporting to acknowledge that not all payments constituting "income" to employees fall into the category of "wages," the court below nevertheless immediately proceeded to cite with favor this Court's discussion of the broad definition of income in *Commissioner* v. *LoBue*, 351 U.S. 243 (1956). In *LoBue*, this Court held that an employee realized "gross income" within the meaning of the predecessor of Section 61 of the Code at the time he exercised stock options granted to him in order to confer a "proprietary interest" in the company for which he worked. Thus, the Seventh Circuit failed at the outset to state the "right question" or to appreciate the distinction between "income" and "wages."

The court of appeals below cited only two "wage" cases in support of its conclusion that an "expansive" definition of employers' withholding obligations was appropriate: *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946), and *Educational Fund of Electrical Industry* v. *United States*, 426 F.2d 1053 (2d Cir. 1970) (App. 24–25). However, in both *Nierotko* and *Educational Fund* the facts were totally disimilar to the present case in that the payments at issue were made in lieu of and as a substitute for actual pay. In *Nierotko*, for example, this Court held that "back pay" awarded by the National Labor Relations Board to a wrongfully discharged employee constituted "wages" for purposes of federal old age benefits under the Social Security Act.[13] The Court's opinion contains broad dicta concerning the meaning of "wages" for purposes of FICA tax withholding. 327 U.S. at 365–66. The actual basis for the decision of the Court is most clearly explained by Mr. Justice Frankfurter in his concurring opinion:

> [A]n employer must pay wages although in violation of law, he has subjected his employee to enforced idleness. Since such compensation is in fact paid as wages, it is a plain disregard of the law for the Social Security Board not to include such payments among the employees' wages.

327 U.S. at 371.

[13]"Wages" is defined in the Social Security Act as "remuneration for employment" and "employment" is defined as "any service . . . performed . . . by an employee for his employer." 42 U.S.C. §409; 26 U.S.C. §3121. Because Social Security is sometimes regarded as a system of employee benefits rather than as a tax, "wages" has often been interpreted differently for purposes of F.I.C.A. and F.U.T.A. withholding than for purposes of income tax withholding. *See* IRM MT 4600-21 (5/1/74) (Official Use Only): Technical Guidelines for Disposition of Employment Tax Cases. *But cf. Royster Co.* v. *United States*, 479 F.2d 387, 390 (4th Cir. 1973). No issue is presented here that FICA and FUTA withholding were required.

Similarly, the *Educational Fund* case involved payments made as a substitute for actual pay. In that case, electricians were allowed one week off, without pay, by their employers to attend school. Upon successful completion of their courses, however, the electricians were given $140 "as partial compensation for lost wages and expenses." 426 F.2d at 1055. The Second Circuit rejected the contention that the $140 payments were an expense allowance, finding that "[t]he payments bore no relation to any expenses actually incurred by those electricians who attended the school." 426 F.2d at 1056–57.

In sharp contrast, both courts below characterized the payments in this case as reimbursements for legitimate travel expenses. This case does not involve payments made in lieu of wages; *Nierotko* and *Educational Fund* are simply irrelevant.

B. UNDER THE WITHHOLDING TAX PROVISIONS THE TERM "WAGES" INCLUDES ONLY REMUNERATION FOR SERVICES PERFORMED

Section 3401(a) of the Code confines the definition of "wages" to "remuneration . . . for services performed." The theme underlying the Treasury regulations and the court decisions considering the term "wages" is that payments made for a noncompensatory business reason of the employer—*i.e.*, in furtherance of the employer's business—cannot be characterized as remuneration for services performed, which is the crucial determination under the withholding provisions.[14]

[14]Even the government does not deny the significance of an employer's noncompensatory business reason. Indeed, it acknowledges that in certain circumstances "cash allowances do not 'represent compensation' to the employee because they are in furtherance of the employer's business." (Brief for Petitioner at 25, *Commissioner* v. *Kowalski*, No. 76-1095 (Sup. Ct., filed Feb. 7, 1977), *cert. granted*, 97 S. Ct. 1578 (1977)). Further, the noncompensatory business reason of the employer need not be the sole factor prompting the furnishing of the item to the employee. *See* Treas. Reg. §1.119-1(a)(2).

In each of the decisions discussed above at pp. 16-18, as in the instant case, the payments or reimbursements were determined without regard to, and in no way were related to, an employee's wage rate, job status or value of his services to the employer. The reimbursements were not intended to be for, and were not measured by, services performed. As the court stated in *Humble Pipe Line*:

> Thus, the amounts which the plaintiff expended in defraying the moving costs of its employees were, "from plaintiff's point of view as an employer, expenditures incurred to advance its own wholly legitimate and bona fide business purposes." Peoples Life Insurance Co. v. United States, 373 F.2d 924, 929, 179 Ct. Cl. 318, 327 (1967). It follows that, in paying out amounts to defray its employees' moving costs, the plaintiff was not compensating or otherwise rewarding the employees for services rendered by them.

442 F.2d 1353, 1356-57 (Ct. Cl. 1971). *See also* the recent opinion in *Allstate Insurance Co.* v. *United States*, 530 F.2d 378, 380, 383 (Ct. Cl. 1976).

The facts of this case demonstrate conclusively that the reimbursements to employees of the Company cannot be characterized as remuneration for services performed. The Company reimbursed its employees for their legitimate expenses, including noon meal expenses, when they were traveling on behalf of the Company (App. 16, 22). These payments were in the form of reimbursements, not pre-paid unrestricted cash allowances, and were subject to careful scrutiny by appropriate supervisory Company personnel. The accounting for expenses, which each employee was required to submit in order to receive the reimbursement, was done on forms supplied by the Company for this purpose. These forms had to be approved in writing by the employee's supervisor (App. 16; Transcript 32–37). At all times the reimbursements were treated on the Company's books as travel expenses and were never placed in the salary account or described as a salary

item or an addition to an employee's base salary (Transcript 21, 43). The amount of the reimbursement was specifically identified as travel expenses upon payment to the employee (Plaintiff's [district court] Exhibit 11; Transcript 40). Both courts below found that the expenses were incurred in legitimate travel on behalf of the Company (App. 16, 22).

The amount of reimbursement was not a function of the rank of the employee, or related in any way to his specific job title, nature of work, rate of pay or value of service to the Company (App. 17). The reimbursement was not for any service performed by the employee; the employee was not on duty during the noon hour, nor was he subject to call more than during other non-working hours (App. 17).

The Company's established reimbursement policy was for noncompensatory business purposes. The reimbursement policy was instituted for the economic benefit of the Company and the payments were limited to legitimate transportation, meal and lodging expenses of employees traveling on the business of the Company. The policy avoided the cost of transporting the employees back to Company headquarters and the attendant loss of work-hours. (App. 17) The reimbursed amount and the Company's policy did not vary according to whether the travel was overnight or nonovernight (Transcript 24–29). To contend that a policy established for noncompensatory business reasons of the Company in furtherance of its business results in remuneration for services performed—and somehow with respect to the noon meal expense portion only—requires "a departure from the realities of business life and a vigorous stretching" of the statutory meaning of "wages" (App. 17).

C. AN "EXPANSIVE" DEFINITION OF WAGES IS INCONSISTENT WITH THE EXISTING WITHHOLDING SYSTEM

The decision of the court of appeals below apparently was based on the court's own concept of the withholding system

without regard to the statute, Congressional intent or the all-important consideration of establishing a system that will operate simply and fairly. The court stated: "This expansive definition of 'wages' seems appropriate and harmonizes well with the underlying purposes of the withholding tax system to collect income at its source and to prevent unexpected burdensome tax liabilities come April 15" (App. 25, footnote omitted).

As shown above (pp. 10-12), Congress elected to establish an intentionally narrow and precise scope to employers' withholding obligations by requiring withholding only on "wages" because it served "the interest of simplicity and ease of administration." The court of appeals improperly undertook to substitute its judgment for that of Congress. As this Court has recognized:

> [i]n the interpretation of statutues levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear impact of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out.

Gould v. *Gould*, 245 U.S. 151, 153 (1917). *Accord, United States* v. *Merriam*, 263 U.S. 179, 187–88 (1923); *Allstate Insurance Co.* v. *United States*, 530 F.2d 378 (Ct. Cl. 1976).

The court of appeals unwittingly has opened a pandora's box which could disrupt the operation of the withholding system. As observed by the Treasury Department recently in discussing withholding on fringe benefits: "If we should attempt to include in the withholding base every economic benefit enjoyed by great numbers of employees, the operation of the system would be seriously jeopardized."[15]

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[15]Office of the Ass't Sec'y for Tax Policy, Summary and Discussion Draft of Proposed Regulations on Fringe Benefits, Daily Tax Rep. (BNA), No. 172, at J-9 (September 4, 1975).

The present withholding system works well because employers' obligations intentionally are simple and unambiguous. The difficulties of an indiscriminate extension of the withholding system are far-reaching, as Congress already has recognized. Employers cannot be forced to speculate at their own risk as to items on which withholding is required.

The court of appeals below obviously failed to appreciate the confusion it would introduce, and the repercussions of its decision, when it extended the definition of "wages" to encompass virtually every payment or benefit attributable to, or arising out of, the employment relationship. It has told employers, in effect, that they no longer can rely on the Treasury regulations, which have remained unchanged since promulgation in 1943, excluding travel expense reimbursements from the definition of wages.[16] It apparently also is telling employers that they have withholding obligations on certain non-cash items (which may or not be susceptible of valuation) which the Internal Revenue Service itself has not yet determined are taxable, much less "wages."[17]

The impact of the court of appeals' decision is to place almost every employer in violation of the withholding tax provisions, including the government.[18] This result will be

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[16]Treas. Reg. §31.3401(a)-1(b)(2), discussed, *supra*, pp. 12-14.

[17]*E.g.*, such so-called "fringe benefits" as free parking, health services, use of government or company automobile, cafeterias, gymnasiums, etc. Commissioner Kurtz of the Internal Revenue Service has recently asked his Advisory Group for its views as to the taxability of such "fringe benefits." *See* Daily Tax Rep. (BNA), No. 110, at J-9 (June 7, 1977). The previous administration was unable to articulate which of these benefits should be taxed. *See* Treasury Department Statement, December 17, 1976, on Withdrawal of Discussion Draft of Proposed Regulations on Taxation of Fringe Benefits, Daily Tax Rep. (BNA) No. 245, at J-9 (Dec. 20, 1976).

[18]In Tax Management Memorandum, TMM 75–03, at p. 8 (February 3, 1975), it is noted:

(footnote continued next page)

repeated in the future if employers are required to guess at the meaning of an "expansive" judicial definition to perform their duties under the law. Congress has shown that it is well aware that a viable withholding system requires specific and simple guidelines. The system was never intended either to operate as the court of appeals below assumed would be "appropriate" or to be extended as the government has proposed.[19]

> . . . Tax Management has been advised that some employees of the Federal Government receive a partial *per diem* allowance to cover comparable travel expenses [to those in *Royster Co.* v. *United States*, 479 F.2d 387 (4th Cir. 1973)] in situations where they are not away from home overnight, and that the Federal government does not withhold tax on such amounts.

Further, as the government's own announcements show (*see, supra*, note 17 and accompanying text), the government does not treat fringe benefits to its employees as income and, undoubtedly, does not withhold on any such amounts.

[19]The Internal Revenue Service proposed in Rev. Rul. 69–592, 1969–2 Cum. Bull. 193, that withholding be required on travel reimbursements if:

> it is reasonable to believe, under all the facts and circumstances known to the employer at the time of the reimbursement, that the total per diem allowances paid to an employee during the taxable year will exceed the total of his deductible travel expenses incurred while he is traveling away from home on business. . . .

The total lack of any support in law for this position is shown by the fact that the ruling never once uses the word "wages," and never once recognizes the existence of the long-standing Treasury regulations relating to travel expenses. But even accepting the ruling on its face, the proposed test is unworkable. Under this ruling, the government would impose on each employer the obligation of determining the personal tax situation of each of its employees, and predicting the travel for each during the year, in order to ascertain any withholding obligations on travel reimbursements made to them.

II

RETROACTIVE IMPOSITION OF TAX WITHHOLDING OBLIGATIONS ON EMPLOYERS IS AN ABUSE OF DISCRETION

In the thirty-five years in which the modern income tax withholding system has been in operation, Congress has never acted to expand the scope of employers' withholding obligations or to increase the amount required to be withheld without giving employers a grace period to adjust to the new requirements. Congress has granted this relief as "a matter of equity and custom."[20] Moreover, Congress has observed that when the Internal Revenue Service attempts to enforce new withholding requirements retroactively, it "creates havoc" in the payroll tax system (*see, infra*, p. 27).

A. EMPLOYERS ARE NOT OBLIGATED TO BE GUARANTORS OF TAX PAYMENTS LATER DEEMED SUBJECT TO WITHHOLDING

Congress has provided under Sections 3402 and 3501 of the Code that employers must collect federal taxes from "wages" which they owe to their employees and pay over such amounts to the government. The taxes being collected are those of the *employees* and the employers act as mere conduits. While employers may be liable for payment of the tax if they fail to withhold as required, this provision does not elevate the basic function of the employers to something more than collecting agents.

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[20]S. Rep. No. 66, 95th Cong., 1st Sess. 85–87, referring to action taken in 1977 by Congress to relieve employers of liability for failure to deduct and withhold taxes in 1976 from certain amounts such as sick pay which, but for the enactment of the Tax Reform Act of 1976 late in 1976, would not have been subject to withholding in 1976. *See* Tax Reduction and Simplification Act of 1977, Pub. L. No. 95–30, §404, 91 Stat. 126 (1977).

Because employers collect the tax from payments *to be made*, they are entitled to know in advance with clarity the nature and scope of their withholding obligations. If employers make payment without withholding because the law or administrative practice does not then require withholding, a later change in the rules, if applied retroactively, necessarily results in making employers absolute guarantors for the collection of their employees' taxes.[21]

The Court of Claims in *Humble Oil & Refining Co.* v. *United States*, 442 F.2d 1362 (1971), has criticized the government for attempting to hold an employer as a guarantor in a similar case involving reimbursements paid to employees for certain moving expenses. The court said:

> Thus, in 1961, Humble had no reason to suspect that when, for its own benefit, it reimbursed the moving expenses of its *existing* employees, it was paying them wages "for services performed" as defined in section 3402. Under these circumstances, Humble should not be penalized and used "as a device . . . to determine the basic tax liability" of its employees who are not even parties to this case. (emphasis in original)

442 F.2d at 1369-70 (quoting from *Peoples Life Insurance Co.* v. *United States*, 373 F.2d 924, 933 (Ct. Cl. 1967)).[22]

[21]Section 3402(d) of the Code provides that if a nonwithholding employer can show that its employees paid the tax which should have been withheld, the employer is not liable for the tax. However, this is usually impossible as a practical matter.

[22]This passage from *Humble Oil* is dicta because the Court of Claims had already rejected the attempt by the Service to characterize such reimbursements as "wages." *See Allstate Insurance Co.* v. *United States*, 530 F.2d 378 (Ct. Cl. 1976). Because the government has consistently failed in its attempts to obtain judicial expansion of the definition of "wages," whether such a changed definition should be applied retroactively is an issue of first impression in this case. The issue was extensively briefed in the court of appeals below (*see* Brief for the Appellee at 22-26; Reply Brief at 15-19), but that court ignored the problem in its opinion, even though the government acknowledged that employers had not been on notice as to the need to withhold. (*See, infra*, note 29).

Reacting to a similar pattern of litigation, Congress has recently told the Internal Revenue Service not to apply new administrative positions retroactively against employers who failed to withhold on payments made to persons whom they reasonably thought were "independent contractors," and therefore not subject to withholding.[23] The Conference Committee for the Tax Reform Act of 1976, Pub. L. 94-455, observed:

> Most of our income taxes, almost all of our social security taxes, and all of our unemployment taxes come in through the payroll tax system. *We cannot afford to have this system disrupted. The IRS creates havoc when it comes in for all past years if it changes its formal position as to typical contractual arrangements in an industry*, or if the IRS suddenly begins to treat as an employment relationship the sort of situation which for a long time it has accepted on an industry-wide basis as an independent contractor arrangement. . . . (emphasis supplied)[24]

The problem caused by retroactive enforcement of new withholding requirements is the same, whether such requirements are established through manipulation of the term "independent contractor" or of the term "wages."[25] Employers who complied with existing law at the time for withholding are held liable, though they are without fault.

[23]S. Rep. No. 938, 94th Cong., 2d Sess. 604; S. Rep. No. 1236, 94th Cong., 2d Sess. 489, *reprinted in* 1976-3 Cum. Bull. 807, 897. Congress requested the Joint Committee on Taxation to study problems regarding the definition of "independent contractors" as contrasted with "employees."

[24]122 Cong. Rec. S12,496 (Daily ed. July 26, 1976) (adopting remarks of Senator Long), incorporated in S. Rep. No. 1236, 94th Cong., 2d Sess. 489, *reprinted in* 1976–3 Cum. Bull. 807, 893.

[25]The Internal Revenue Service is presently planning a campaign to tax "fringe benefits" which have not, as a matter of administrative policy, been taxed before (*see, supra*, note 17). If these benefits are taxed, the government may attempt to require employers to withhold on such benefits, even though they are not in the form of

(footnote continued on next page)

Congress has given the Secretary of the Treasury the authority to "prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect." Section 7805(b) of the Code. This Court has ruled that under this section the Internal Revenue Service has "a large measure of discretion" in determining when to apply changes in the law retroactively. *Dixon* v. *United States*, 381 U.S. 68, 79–80 (1965). However, this Court's decision in *Dixon* has never been thought to provide the government with unlimited authority to apply new positions retroactively or to insulate the use of its discretion from judicial review. The Internal Revenue Service may not use this power arbitrarily to favor one taxpayer over another. *International Business Machines* v. *United States*, 343 F.2d 914 (Ct. Cl. 1965). Nor may it depart abruptly from established administrative positions without an adequate explanation. *Atchison, T. & S. F. Ry. Co.* v. *Wichita Bd. of Trade*, 412 U.S. 800, 807–08 (1973); *Sirbo Holdings, Inc.* v. *Commissioner*, 476 F.2d 981, 987 (2d Cir. 1973) (Friendly, C.J.).

Discretion implies prudence, restraint and fairness. It also implies that agents in collecting the revenues, such as employers, be adequately informed of their obligations in advance. Retroactive enforcement of new rules by the government shifts the burden of the tax from the employees upon whom Congress imposed it, to the employer.

The Internal Revenue Service has recognized from time to time that withholding should not be imposed retroactively where employers had no reasonable basis to believe that

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cash payments or readily susceptible of valuation. Retroactive enforcement of any such withholding requirements for all open years would create chaos in the American business community. Yet what difference is there between the position of the Company with respect to legitimate travel expenses incurred in 1963 and the position of most employers today with respect to fringe benefits provided their employees?

withholding was or would be required at the time payments were made. For example, in Rev. Rul. 76-453, 1976-2 Cum. Bull. 86, the Service announced that it intended to reverse an earlier position and hold that reimbursements for certain traveling expenses to temporary jobsites (for example, travel from an employee's residence directly to a client's office) would constitute nondeductible income to employees, citing the decision of the Tax Court in *Turner* v. *Commissioner*, 56 T.C. 27 (1971). The ruling also announced that such reimbursements would be considered to be "wages" subject to FICA, FUTA, and income tax withholding as of the effective date of the ruling. The effective date of the ruling continues to be postponed, however, "[t]o allow employers additional time to advise their employees of the effect of the ruling and to make necessary changes in their accounting and business procedures."[26]

In like manner, with respect to the payments of "supper money" to employees who work overtime, the Internal Revenue Service instructed its agents in 1974 in the Internal Revenue Agent's Manual[27] that O.D. 514, 2 Cum. Bull. 90 (1920), holding such payments not to be income to the employees because paid for the convenience of the employer, should be viewed as precluding retroactive assessments of withholding taxes. The Manual states: "Pending publication of regulations clarifying the Service's position, examining officers are instructed not to raise the issue of the applicability of income tax withholding with respect to such payments."[28]

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[26]IRS News Release IR-1724, [1977] 9 Stand. Fed. Tax. Rep. (CCH) ¶6630; Announcement 77-113, 1977-28 I.R.B. at ___. *See also* Rev. Rul. 75-44, 1975-1 Cum. Bull. 15; Rev. Rul. 64-40, 1964-1 Cum. Bull. 68; Rev. Rul. 62-150, 1962-2 Cum. Bull. 213.

[27]IRM MT 4600-21 (5/1/74) (Official Use Only): Technical Guidelines for Disposition of Employment Tax Cases.

[28]*Id.*

B. IT WAS REASONABLE FOR THE COMPANY TO BELIEVE WHEN IT PAID THE MEAL REIMBURSEMENTS THAT THEY WERE NOT "WAGES" SUBJECT TO WITHHOLDING

In 1963, not one regulation, revenue ruling or judicial decision required withholding on any travel expense reimbursements. In fact, the regulations specifically provided, as they do now, that "[a]mounts paid—either as advancements or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred . . . in the business of the employer are not wages and are not subject to withholding." Treas. Reg. §31.3401(a)-1(b)(2), *supra*, pp. 12-13.

It is not disputed that the reimbursements paid in this case were expenses incurred by employees while on legitimate travel for the business of the Company (App. 16, 22). In these circumstances, no employer reading the regulations in 1963 would reasonably suspect that a withholding requirement existed.[29]

The government contended in the court below that an old ruling, I.T. 3395, 1940-2 Cum. Bull. 64 (which pre-dated the withholding regulations adopted in 1943), should have put the Company on notice that withholding was required. I.T. 3395 allowed an income tax deduction to locomotive engineers and other railroad trainmen for their expenses of room and meals on trips for the business of their employer during which they stopped for rest. Thus, this ruling involved an income tax deduction to employees and not a withholding tax

[29]The government is well aware that employers heretofore have not been apprised of the need to withhold. In its Reply Brief at p. 15, the government stated to the court of appeals below:

> . . . we urge that the Court not consider this issue [*i.e.* retroactivity] until it has passed upon the primary question which is of considerable importance as a precedent and the resolution of which is essential so that the instant taxpayer, and other employers making similar payments, will be on notice as to the need for withholding.

question. Apparently, the government now views this ruling as a veiled announcement of its "overnight" rule (*see, supra*, pp. 13-14). Significantly, the government itself did not deem it appropriate to reflect this ruling in its withholding tax regulations adopted shortly after the ruling was issued (*see, supra*, p. 13); it is hardly reasonable to expect that employers should have done so.

In 1963, when the reimbursement payments at issue were made, judicial decisions supported a reasonable belief that an offsetting deduction would be available to employees receiving reimbursements in connection with non-overnight business trips. In *Hanson* v. *Commissioner*, 298 F.2d 391 (8th Cir. 1962), the Eighth Circuit rejected the government's position that meal expenses are only deductible under Section 162 when incurred in connection with a trip involving an overnight stay. Prior to the 1962 decision in *Hanson*, the overnight rule had been rejected by the Fifth Circuit in *Williams* v. *Patterson*, 286 F.2d 333 (5th Cir. 1961), and by the First Circuit and a Minnesota district court in cases involving non-meal travel expenses. *Chandler* v. *Commissioner*, 226 F.2d 467 (1st Cir. 1955), and *Scott* v. *Kelm*, 110 F. Supp. 819 (D. Minn. 1953).

In decisions issued after 1963, the overnight rule continued to be rejected by the courts. In *Ahrens* v. *United States*, 264 F. Supp. 518 (S.D. Ill. 1967), in a case involving one of the Company's employees, the court held that noon meal reimbursements of the exact type here in issue gave rise to an employee deduction under Section 162 of the Internal Revenue Code. *See also Correll* v. *United States*, 369 F.2d 86 (6th Cir. 1966), *rev'd*, 389 US. 299 (1967). It was not until this Court's decision in *United States* v. *Correll*, 389 U.S. 299 (1967), rendered in December, 1967 (more than four years after the meal reimbursements at issue were paid by the Company), a case decided principally on the basis of convenience in the administration of the tax laws, that meal payments in con-

nection with a trip not involving an overnight stop were held not to be deductible by employees under Section 162 of the Code.

None of the courts in these cases including this Court in *Correll* considered the withholding tax question or was asked to do so. Until the decision of the court of appeals below, no court ever had held travel reimbursements to be "wages."

The first published pronouncement by the Internal Revenue Service regarding withholding on travel expenses did not come until 1969 in Rev. Rul. 69-592, 1969-2 Cum. Bull. 193. Apparently, this ruling was precipitated by this Court's holding in *United States* v. *Correll*, 389 U.S. 299 (1967). The ruling suggests a possible requirement of withholding on reimbursed travel expenses which exceed travel deductions but it avoids any mention of the statutory requirement that a payment must be a "wage" to be subject to withholding. Thus, the ruling tacitly appears to recognize that a requirement of withholding on travel expense reimbursements is not supported by the statutory definition of "wages." Significantly, the ruling also recognizes that employers reasonably could not be expected to have foreseen a withholding requirement on travel expense reimbursements. The ruling states:

> *Accordingly, unless it is reasonable to believe, under all the facts and circumstances known to the employer at the time of the reimbursement,* that the total per diem allowances paid to an employee during the taxable year will exceed the total of his deductible travel expenses incurred while he is traveling away from home on business, *no withholding of income tax is required with respect to per diem allowances paid to cover his meal expenses on trips that do not require him to stop for sleep or rest.* (emphasis supplied)

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be reversed. Petitioner also requests a remand to the district court for the award of attorney's fees pursuant to 42 U.S.C. §1988.

Respectfully submitted,

SHARON L. KING
One First National Plaza
Suite 4200
Chicago, IL 60603

Of Counsel:

ROBERT E. CRONIN
GERALD D. MINDELL
THOMAS G. RYAN
PHILIP P. STEPTOE

ISHAM, LINCOLN & BEALE

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C. 1958 ed.):

SEC. 3401. DEFINITIONS.

(a) *Wages.*

For purposes of this chapter, the term "wages" means all remuneration . . . for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash . . . .

• • • •

SEC. 3402. INCOME TAX COLLECTED AT SOURCE.

(a) *Requirement of withholding.*

Every employer making payment of wages shall deduct and withhold upon such wages (except as otherwise provided in this section) a tax determined in accordance with the following tables . . . .

• • • •

SEC. 3403. LIABILITY FOR TAX.

The employer shall be liable for the payment of the tax required to be deducted and withheld under this chapter, and shall not be liable to any person for the amount of any such payment.

• • • •

SEC. 6041. INFORMATION AT SOURCE.

(a) *Payments of $600 or more.*

All persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income . . .

of $600 or more in any taxable year, . . . shall render a true and accurate return to the Secretary, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

• • • •

SEC. 7805. RULES AND REGULATIONS

(a) *Authorization*

. . . [T]he Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

(b) *Retroactivity of regulations or rulings.*

The Secretary may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.

• • • •

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§31.3401(a)-1 *Wages*

(a) In general.

(1) the term "wages" means all remuneration for services performed by an employee for his employer unless specifically exempted under section 3401(a) or excepted under section 3402(e).

(2) The name by which the remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commissions on sales or on insurance premiums, pensions, and retired pay are wages within the meaning of the statute if paid as compensation for services performed by the employee for his employer.

• • • •

(b) *Certain specific items*

• • • •

(2) *Traveling and other expenses.*

Amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding. Traveling and other reimbursed expenses must be identified either by making a separate payment or by specifically indicating the separate amounts where both wages and expense allowances are combined in a single payment.

• • • •

(10) *Facilities or privileges.*

Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as wages subject to withholding if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees.

• • • •

(T. D. 6259, 1957-2 Cum. Bull. 645)